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SUBJ: PAKISTAN-U.S. ENERGY DIALOGUE POINTS TO LONG-TERM SOLUTIONS
FOR THE SECTOR

11. (SBU) Summary: Delegations to the U.S.-Pakistan Energy Dialogue of October 23-24 discussed plans for moving beyond the current difficulties and strategies for addressing longer-term planning. It was clear that Pakistan has made measurable progress in addressing the electricity sector's debt problems and has also taken important first steps to ensure pricing, structure, and operational efficiencies to provide the necessary full cost recovery to make service sustainable. The GOP has the elements of a plan to address the short-term power needs and reduce shortages, but it is less clear that they have the capacity to carry it out.

12. (SBU) For the longer-term, although the delegation recognized the increasing burden on Pakistan's economy of not resolving the energy situation, it is clear that any longer-term strategy is still at best piecemeal and/or incoherent. The GOP continues to look for silver bullet solutions and foreign assistance as the best answer, and appeared unlikely to accept an independent recommendation to create a national energy authority. While the GOP welcomed the range of support provided by U.S. agencies, they look forward to additional announcements of USG assistance. End summary.

A Range of Challenges in the Power Sector

13. (SBU) On October 23-24, a U.S. interagency delegation led by the Secretary's Coordinator for International Energy Assistance (S/CIEA) David Goldwyn and David Lipton, NSC Senior Director for International Economics, met with a large Pakistani delegation, headed by Minister of Water and Power Raja Pervaz Ashraf, in a bilateral energy dialogue. The GOP described its large and growing shortage of electricity as a constraint on economic development and a strain on public finances. A range of representatives of various GOP ministries and public-sector entities outlined the combined effects of a prolonged failure to invest and maintain existing power infrastructure, misaligned economic incentives, diffuse regulatory and operational authorities, deficits in human resource capacity, and the accumulation of "circular debt." These problems had all manifested themselves in a gap between supply and demand of 3,500 to 4,000 MW during the peak summer season.

Differing Views Within the GOP

14. (SBU) With the Pakistan Electric Power Company (PEPCO) Managing

Director Taheer Cheema as the main speaker, the GOP presented its plans to return the sector to a solid footing. While various GOP presenters recognized the need to address the full range of issues, Cheema instead provided a somewhat unrealistic picture suggesting minimal operational issues (e.g. understating the problem of losses in the system, financial difficulties, and the limited financial and operating autonomy of the sectors' entities under the PEPCO umbrella.) Beyond the financial issues, the GOP outlined a program to add some 4,500 MW of generation by the end of 2010 through a combination of rental power plants (between 850 and 2250 MW), new fast-tracked independent power projects (up to 2500 MW), and the rehabilitation of existing facilities (225 MW already underway and 440 MW awaiting funding in Phase II.)

15. (SBU) The GOP delegation was not unanimous in either its presentation of the facts or the best approach to increasing generation in the short term, especially with regard to the infrastructural intricacies of moving large volumes of fuel and the availability of more efficient (compared to fuel oil) natural gas supplies for generation. The GOP comments also reflected differences among the representatives on the usefulness and prospects for completing the rental power projects. A number of the projects included in the plan lacked financing commitments, which GOP representatives hoped would be taken up by donors or the international capital markets.

The U.S. Response

16. (SBU) In response, the U.S. Trade and Development Agency described project support for initiatives in Pakistan's energy

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sector. The Department of Commerce presented best practices for attracting foreign investment and upcoming events and efforts Commerce is undertaking that will benefit Pakistan. The delegation presented support available for private sector financing in the power sector in Pakistan from the Overseas Private Investment Corporation. USAID also reviewed the assistance it provides in Pakistan.

GOP Leery of Abandoning Subsidies

17. (SBU) The dialogue returned repeatedly to the straightforward concept of charging the full cost of producing and distributing electricity. While both sides agreed on the need to support needy populations, the U.S. delegation presented examples used successfully in other countries that did not constrain the growth of the energy sector. While the GOP clearly recognized the necessity of raising tariffs, participants were not yet ready to consider a system without direct or cross subsidies. For example, the GOP noted that the unwillingness of citizens of the FATA region and much of Balochistan to pay any amount for energy would be a long-term burden on the economy. The U.S. delegation acknowledged that some segments of society would be a burden on public coffers. However, that did not obviate the fact that achieving full cost recovery by charging appropriate tariffs would make the power sector economically viable.[p1]

18. (SBU) WAPDA Member Finance Abdul Qadeer stressed that there was wide variance between the collections of the successful distribution companies (DISCOS), primarily in Punjab province, and the rest. Indeed, the successful DISCOS had even neared completion of the financial paperwork to purchase power directly from the not-yet-operational Central Power Purchasing Agency (CPPA). (Note: Under the unbundling plan for PEPCO assets, individual DISCOS were to buy power under a single purchaser model from the CPPA, which in turn would pay the generating companies. Currently, however, PEPCO pools DISCO receipts, cross-subsidizing the DISCOS and hiding losses. End note.) Qadeer said the GOP planned to have the CPPA in operation, with the DISCOS gaining financial autonomy, by March/April 2010. (Note: While WAPDA officials, including WAPDA Chairman Shakeel Durrani, want to see the unbundling of PEPCO, that is not the case for PEPCO officials and others in the GOP. Indeed, the ADB notes that PEPCO has centralized its authority in recent months, taking further control of DISCO finances and human resources. End note.)

Sector Finance - the Debt

¶9. (SBU) Finance Minister Shaukat Tarin and NSC Director Lipton led discussions on Pakistan's moves to resolve inter-corporate or "circular debt." MinFin Tarin tied together the resolution of circular debt, righting the tariff pricing policies and electricity subsidies, and the sector's prudent governance as integral to the financial sustainability of the energy sector and, indeed, Pakistan's entire financial system. While different numbers were presented by different entities, Finance Secretary Salman Siddique indicated that debt totaling 216 billion rupee (\$2.6 billion) owed by the sector to banks is now being serviced by the GOP. Another 92 billion rupees (\$1.1 billion), which largely covered FATA receivables, had recently been flushed out of the system through the issuance of term finance certificates. [p2]Another 20 billion rupees (\$240 million) is owed to PEPCO by provincial governments, and 39 billion rupees (\$470 million) by Karachi Electric Supply Company (KESC). The Ministry is working with PEPCO and the provinces to collect missing payments and recently reconciled successfully KESC receivables and payables. Siddique indicated that these outstanding issues would be resolved soon.

Sector Finance - the Tariffs

¶10. (SBU) Responding to questions regarding the GOP's ability to manage the subsidy and tariff adjustments in a systematic manner, as well as the adequacy of the amounts budgeted for subsidies this

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year, Tarin said the GOP is "wholly committed to success" in the financial context. He said that RS 55 billion (\$660 million) subsidy budgeted for FY 2009-10 "would have to suffice" to cover revenue shortfalls, even though that amount fell short of a number of projections for the revenue gap.

¶11. (SBU) Lipton praised the GOP's progress in debt reorganization but noted that it had to be sustained. He suggested that progress in the energy sector in other countries required the appointment of a powerful executive or "energy czar" in the face of such high risk priorities to coordinate and motivate an intergovernmental implementation mission.

Upstream Elements: The Fuel Mix

¶12. (SBU) The delegations reviewed the sources of primary energy in Pakistan and the approaches and policies to move beyond Pakistan's current heavy reliance on hydrocarbons. Hydrocarbon Development Institute of Pakistan Director General Halal Raza called [m3]the country's heavy dependence on imported fossil fuels a strain on Pakistan's fiscal health: \$12 billion (63 percent of Pakistan's export earnings) were spent on oil imports in FY 2008. That total would rise to \$60 billion by 2025 without policy adjustments. Much of the rehabilitated generation that is planned will run on expensive and low efficiency residual fuel oil until natural gas supplies increase. Discussion focused on how to correct these imbalances, as well as how to address the critical shortage of human resource capital.

Natural Gas in Short Supply

¶13. (SBU) The delegations shared best practices on exploration and production in the gas sector, how to obtain natural gas imports, as well as how to set up effective royalty systems, particularly in conflict-affected areas. The GOP [p4]did not fully address conflicts with the provinces over gas exploration. The GOP delegation explained ambitious plans for regional pipeline projects. However, several GOP delegation members voiced skepticism, notably after Goldwyn reviewed U.S. sanctions as they might apply to an Iran pipeline, as well as the technical and commercial obstacles confronting such a project. The Ministry of Petroleum indicated it sees an important role over the next 15 years for LNG imports (Note: The Minister of Petroleum and Natural Resources did not attend the Dialogue because of negotiations with gas suppliers in London. End Note) Ministry of Petroleum and Natural Resources Secretary Mahmood Saleem Mahmood said the GOP hoped to conclude its LNG supply and terminal arrangements by December, with trade commencing in 2011.

He did not indicate which of the several LNG projects would be chosen.

Coal

¶14. (SBU) On coal, Sindh Thar Coal Energy Board Director Ijaz Ali Khan discussed the possibilities of this underexplored deposit. Coal, as with gas, turned on the question of the immense infrastructure framework that must accompany any such project. Khan described a range of Thar coal blocks that have been identified and awarded to different parties for development using varied approaches, including coal bed methane, gasification, and traditional mining. He did not have concrete solutions for the many infrastructure challenges surrounding Thar exploration and presented some ideas that run contrary to GOP policy (e.g. private sector investments in transmission).

Hydro and Alternative Energy

¶15. (SBU) While some of the smaller, run-of-the-river projects are moving forward with private investment, the larger projects are having difficulty mobilizing for want of sufficient capital. The GOP representatives presented an approach for private sector participation in smaller to medium-sized hydro sector projects that do not require significant new reservoirs[p5], several of them already advancing. WAPDA Chairman Durrani outlined several mega

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projects that would rely on financial contributions from the ADB and China, among others.

¶16. (SBU) The Alternative Energy Development Board presented bold renewable energy goals that are now struggling to move beyond the concept phase. The projects involve wind, solar, and biomass, and call for private sector financing. Establishing an appropriate tariff for power generated from alternative energy sources remains a major obstacle.

Regional Electricity Trade

¶17. (SBU) The GOP also noted its continued interest in an electricity connection with Central Asia and outlined arrangements with Iran. Existing electricity trade with Iran supplies Balochistan's border areas, as well as 30 MW to the Gwadar port; however, the GOP hopes that a current feasibility study will firm up a project to trade 1,000 MW with Iran in a connection to Quetta.

Integrated Plan: Pulling it All Together?

¶18. (SBU) The GOP presented the results of a blue ribbon private sector panel, commissioned by the Ministry of Finance, to develop an integrated energy plan. This 15-year plan envisages a holistic, self-sufficient, and sustainable approach to energy that, at its core, seeks to create an enabling environment for the growth of Pakistan's energy economy. While the authors admitted it needed further development, they put forward a useful set of policy recommendations. The U.S. delegation responded favorably to the plan's range of issues and diagnosis, notably the key element of creating a national energy authority. Such a quasi-ministry would be charged with overseeing the coordinated implementation of the integrated plan, have transparent workings, and independent, qualified directors from federal, provincial, and private sectors.

¶19. (SBU) Unfortunately, representatives of the established ministries and planning authorities seemed to consider the plan as only one set of ideas to be taken under advisement. In the words of Pervaiz Butt, Member Energy of the Planning Commission, "it is not a reference document, merely a set of ideas." The Planning Commission is now finalizing its own, competing five-year plan. It described a more traditional list of power projects without a focus on structural and policy issues to make the plan viable or even a rank ordering of priorities. Even more revealing was the Planning Division Secretary Ashraf Hayat's comment that the plan did not need to consider financing since the sector is "self-sustaining."

Comment

¶20. (SBU) The Energy Dialogue presented an important opportunity to have a frank exchange on the challenges Pakistan faces in its energy sector, as well as to examine some possible solutions. In many ways this Dialogue was a forcing event for the GOP to clarify its direction in the face of crisis - it is possible this was the first time the various ministries and departments had talked about these issues directly to each other.

¶21. (SBU) The GOP has all the elements it needs to deal with the immediate problems: the additional energy generation coming on line through year-end will be an important deliverable to offset the impact of tariff increases in the public mind, and the circular debt issue appears headed in the right direction. However, implementing these plans fully will be the true test. The ADB, in particular presented, the view that Pakistan's efforts on energy had stalled to the point that ADB might need to reconsider the breadth of its commitments to the power sector.

¶22. (SBU) Although MinFin Tarin again demonstrated his comprehension of the situation and steps necessary to address it[m6], the same cannot be said of the array of other GOP entities that must contribute. Indeed, some continued to deny the reality of the crisis. PM Gilani announced the creation of an executive committee

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to report to him with weekly energy updates. While this could be a real step forward we note that an earlier ministerial level committee (also chaired by the PM) has not had significant impact of which we are aware. Similarly[p7], while the integrated energy plan is encouraging, its characterization as ideas from a "think tank" show that many in the line ministries do not yet accept the need for a holistic approach to address Pakistan's energy woes and seem incapable of moving from goals to strategies - preferring instead to look for salvation in silver bullets and the development of major projects by friends. Although the policy discussion was significant, GOP officials also returned to the need for the U.S. to demonstrate its commitment to Pakistan through projects. While we and other international actors view a national energy authority as a critical step in the long term, the timing may not be appropriate for a bureaucratic reshuffling. End Comment.

¶23. (U) All formal presentations presented by both sides available from SCA/P on request.

¶24. (U) S/CIEA Goldwyn, NSC Director Lipton and the S/SRAP office cleared this message.

¶25. (U) List of Participants

Raja Pervez Ashraf, Minister for Water and Power
Shaukat Tarin, Minister of Finance
Hinna Rabbani Khar, Minister of State for Economic Affairs
Shahid Rafi, Secretary, Ministry of Water and Power
Salman Siddique, Secretary, Ministry of Finance
Ashraf M. Hayat, Secretary, Planning Division
Mahmood Saleem Mahmood, Secretary, Ministry of Petroleum and Natural Resources
Sibtain Fazal Halim, Secretary, Economic Affairs Division
Shahab Khawaja, Secretary, Privatization Commission
Shakeel Durrani, Chairman WAPDA
Zarar Aslam, Additional Secretary, Ministry of Water and Power
Iqbal Awan, Additional Secretary, Ministry of Finance
Tahir Basharat Cheema, Managing Director, PEPCO
Fayyaz Elahi, Managing Director, PPIB
Arif Allahuddin, CEO, AEDB
Abdul Qadeer, Member, WAPDA
Fazal Ahmad Khan, Member, WAPDA
Razi Abbas, CFO, PEPCO
Riaz Ahmad Khan, Advisor, Ministry of Water and Power
Mr. Fazeel Asif, CEO, Power Holding Company
Muhammad Imtiaz Tajwar, Secretary, WAPDA
Zahoor Ahmad Barlas, Joint Secretary, Ministry of Water and Power
Saif Ullah, Joint Secretary, Ministry of Water and Power
Shohail Khan, Director General, Ministry of Foreign Affairs
Masroor Qureshi, Director General, Ministry of Finance

David Goldwyn, Coordinator for International Energy Affairs, S/CIEA
David Lipton, NSC Senior Director for International Economics
Robin Raphel, Economic and Development Assistance Coordinator
Paul Hueper, Senior Advisor, S/CIEA
Mary Beth Goodman, Senior Economics Advisor, S/SRAP
Robert Deutsch, Senior Economic Advisor, SCA/P
Brett Eggleston, Economic Advisor, SCA/P
Thomas Cutler, Acting Director of European & Asian Affairs, DOE
Russell Profozich, Economist, FERC
Jacob Flewelling, Country Manager, USTDA
Gordon Weynand, Senior Energy and Environment Officer, USAID
Will Center, Commercial Counselor, FCS
Jim Barnhart, Director for Economic Growth and Education, USAID
Rosario Calderon, Energy Officer, USAID
Robbie Marks, Deputy Economic Counselor
Saeed Anwar, Economic Specialist

[p1]
[p2]TFCs went towards FATA debt? since when?

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[m3]MB, do you know who this is?
[p4]or "the delegations"?
[p5]"that do not require significant new resoirces??"
[m6]I don't agree with this, but if Litpon does...
[p7]Robbie - they announced this weeks ago; it isn;t new (even though we know it doesn;t actully do much or even probably meet)